THE NEXT GENERATION OF THE AUDIT

Al Anderson, CPA

ACCOUNTability Plus, LLC
DRIVING ACCOUNTING FIRM EXCELLENCE

ABOUT US

Al Anderson, CPA

For over 25 years, ACCOUNT*ability* Plus, LLC has served as a global leader in accounting and assurance advancement.

President Al Anderson, CPA founded ACCOUNT*ability* Plus, LLC to work directly with auditors and firms to transform their operations, achieve efficiency and effectiveness, and surpass client expectations.

As a nationally recognized consultant, educator and speaker, Al expertly guides his clients and their staff through uniquely designed programs and assessments with a future-focused, reality-based approach. Having led innovation for the profession as a firm partner, director, and AICPA executive, Al continues to advance insight and dedicate himself to driving accounting firm excellence. He currently leads the AICPA/Rutgers Data Analytics initiative and serves as advisor to the AICPA and their Audit of the Future initiatives.

More information on Al Anderson and ACCOUNT*ability* Plus, LLC
can be found at www.accountabilityplusllc.com

Denise Clayton Delahanty, Partner

Clayton Delahanty is an accomplished business consultant with over 30 years' experience on people from an employee/leader lens and a customer/marketing lens. Currently, she a key member of the design team for the Audit of the Future.

Prior to founding the Leadership Leagues as a new part of Accountability Plus, Clayton Delahanty was Principal, Senior Strategic Consultant with Gallup and Vice President of Strategic Planning and Research for Rapp Collins. She is an accomplished keynote speaker for several organizations on employee engagement, a speaker on leadership in audit at NATS, a guest lecturer at the University of St. Thomas on Innovation & Creativity, a speaker at various industry associations on ISO 9000 Systems, and a speaker on Strategic Planning, Business Planning, and Customer Integration. Clayton Delahanty received the Governors' Partnership Award for the State of Minnesota, and received the Top 100 Leader designation from Rapp Collins Worldwide among many other awards. She is also a Certified Gallup Strengths Coach, is a Certified Situational Leadership Trainer and was Internal Audit Certified for ISO 9000.

OVERVIEW

Another year, another audit for many companies and their auditors. It's a cycle and process remained essentially unchanged for many years. The current model typically carries out audit procedures after the fact. They are:

- Periodic
- Historic
- Financial statement only
- Looking backward

Advances in technology and the massive proliferation of available information created a new landscape for financial reporting. The next generation audit model must consider the following realities in the business environment today:

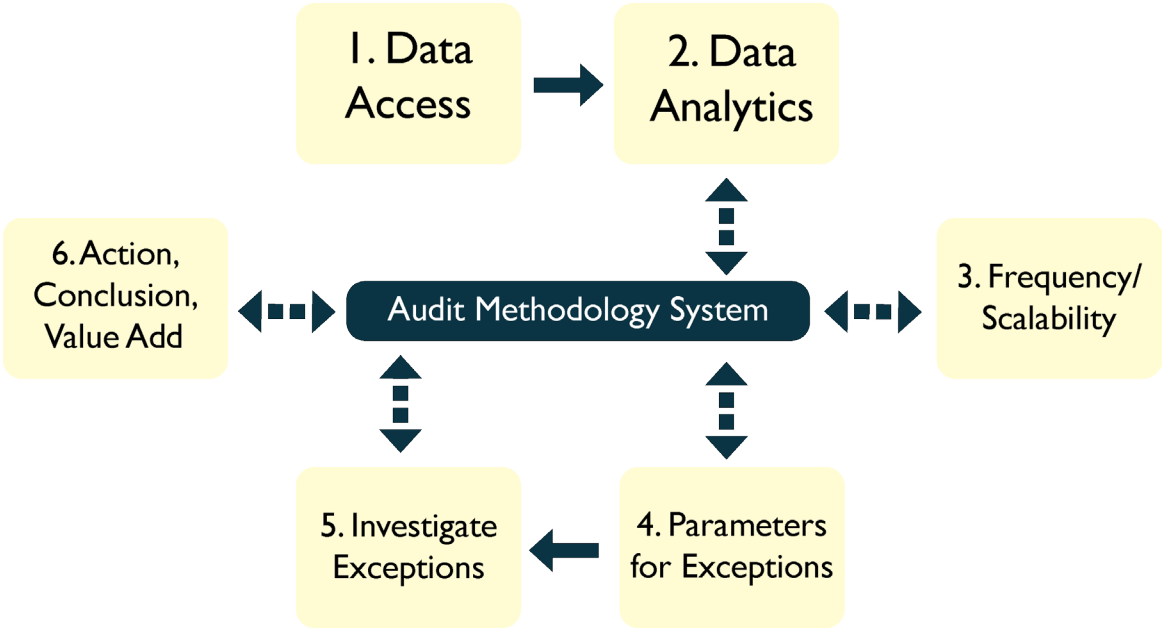
- Business processes are supported by real-time systems
- Many internal processes which are monitored on a close to continuous basis
- Processes and decisions are highly time dependent
- Processes where timely decisions give competitive advantage

The current audit model fails to support the above realities. Auditors must evolve to leverage these realities internally (use of technology) and externally (methods of reporting) to meet the needs of the business and the users of the audited information. The next generation audit model will consider:

- Audit on-demand
- Audit information in real-time or near real-time
- Leveraging "Big Data"
- Reliance on data analytics
- Exception-based auditing
- Adding value by knowledge gained

The audit of the future must consider what in fact is going to the audited. The current model audits information reflected in a set of financial statements. But does the future model stop at this? Should the future model consider some of the elements underlying processes, quality of people and reliable systems? For our purpose of defining the "it," we will assume the next generation audit is an audit opinion related to a basic set of financial statements.

Over time, it will likely evolve to include a broader array of information beyond that of historical based financial information. In a recent survey conducted by Deloitte on the *Future of Audit*, over 2/3 of all respondents said the audit eventually needed to provide assurance on information beyond traditional financial information.



KNOWLEDGE GAINED TO ADD VALUE THROUGHOUT 1.1

A PROTOTYPE DESIGN

The next generation audit methodology will take advantage of the large amounts of data the client has available. Today, in many cases, auditors perform procedures over a relatively small sample of transactions – as few as 30 or 40 – and project conclusions across a much broader population. The next generation methodology (using data analytics) would have the capacity to examine 100 percent of a client's transactions. Auditors will sort, filter and analyze thousands of transactions to identify exceptions or anomalies, making it easier to focus in on areas of potential concern and drill down on those items that may have the highest risks. Doing so increases the potential for more effective audits which also enhance both audit quality and efficiency.

The following diagram 1. 1 illustrates a prototype design of how the methodology can leverage client data through use of data analytics.

These six steps are fundamentally changing the approach for gathering audit evidence. The approach allows the auditor to audit exceptions based upon an analysis of all of the financial transactions of the entity. These financial transactions are the underpinning to summarization and classification. The end result is a financial statement.

STEP 1. DATA ACCESS

This methodology does not necessarily have to generate a report; it is a process that tests transactions based upon prescribed criteria, identifies anomalies, and is the responsibility of the auditor. To identify the anomalies, the audit must have access to the data, commonly referred to as "big data."

Big data is a term describing the large volume of data – both structured and unstructured – inundating a business on a daily basis. This model contemplates the use of the structured data contained within the clients accounting software. Unstructured data, such as email, is not contemplated initially as part of the audit methodology system.
Access to data is one thing, but data quality is essential to auditability and should be evaluated based on:

- How can you verify the completeness of data?

- Accuracy
- Consistency on data formats, naming conventions and precision
- Do multiple data sources agree?
- Exportability and portability
  - » How easy can the data be exported?
- Audit trail
  - » How much effort is required to uncover the change in data values and accountability of the changes?
- Data integrity
  - » Data normalization and standardization is often required before computerize tools start analyzing corporate financial and transactional data
  - » Data conversion costs can be high

There are barriers to data access to consider. First, data access itself. Companies invest in protecting their data, which makes the process of obtaining client approval for complete data access a time consuming effort. In certain cases, clients may refuse to provide data, stating security concerns. In addition, auditors encounter hundreds of different accounting systems and multiple systems within the same company, all containing different sets and types of data.

There are several efforts (for example the ASEC Audit Data Standard) undertaken to provide systems or tools to facilitate the data normalization process, and keep the data conversion costs under control. But it's not the amount of data that's important, it's what auditors can do with the data that matters. Big data can be analyzed for insights that lead to better decisions for the audit process. Thus, the next step is use of data analytics to the client data.

STEP 2. DATA ANALYTICS

Data analytics is the science of examining raw data with the purpose of drawing conclusions from the information. Auditors have used analytics in their methodology for years, but rapidly decreasing technology storage and processing costs are making data analysis even more attractive because of the potential for significant scale and depth.

The new model will look for better ways to embed analytics into the fabric of audits. A basic data analytics program can be outlined as:

- Consideration of potential scenarios resulting in exceptions
- Assessment at various levels: globally (corporate-wide), significant business units, substantial account levels
- Assessment along industry lines, when available
- Testing of the effectiveness of the internal policies and controls
- On-going monitoring and evaluations on a periodic and random frequency to access performance and effectiveness

Once auditors embed analytics in this way, they will be able to examine much larger sets of financial data to better identify issues and analyze trends. Models will need to be developed to assist in the formatting and display of the analytics to allow the auditor to interpret and understand the results much faster. As a result, auditors will provide deeper perspectives on trends and risks. This enhanced perspective will support better decision-making during the risk assessment process and knowledge gained will be a significant value add to the client.

STEP 3. FREQUENCY/SCALABILITY

This model is not designed to be a "one size fits all model" and this is where the data analytics frequency comes into play. Larger, more sophisticated clients can be monitored on a real-time or near real-time basis. Where smaller, less complex clients can have data analytics performed on a less frequent basis; for example, quarterly or even annually. In essence, the frequency of the performance of the audit procedures can be scaled to meet the size and complexity of the client.

STEP 4. PARAMETERS FOR EXCEPTIONS

This process is determined as the audit team understands what data is available to them. This will

connect directly to the auditors risk assessment procedures through a sound understanding of the entity and its environment, including internal controls. Parameters are determined for each risk area the auditor determines during the planning of the engagement and could consider the following:

- Review existing entity process risk documentation
- Review existing analytics for efficiency and effectiveness
- Updates existing analytics for full changing risk
- Conduct additional reviews of entity processes and identify new risk areas
- Identify opportunities for improving process through Data Analytics
- Identify new analytics opportunities within specific entity risk areas
- Identify and verify all compensating controls

Parameters include items such as (a partial list just to provide perspective):

- Authorization limit exceptions:
  - » Single and multiple accumulated values exceeding limits
  - » Transaction amounts that exceed or are just below the authorization limit
    - Requisitions, Purchase Orders, Invoices, Payments
  - » Accumulated transaction amounts that exceed the authorization limit
    - Split Requisitions, Split Purchase Orders, Split Invoices, Split Payments

- Timing or aging exceptions
  - » Single Record Age
    - Days difference between Create Date and Approval Date
    - Stale Requisitions, Stale Purchase Orders, Stale Invoices
  - » Multiple Files Aging
  - » Retroactive PO vs. Invoice (Invoice Create Date prior to PO Create Date)

- Matching (Join) - Amounts over variance thresholds
  - » PO Line Item vs. Invoice Line Item
  - » PO Line Item Quantity vs. Goods Received Quantity
  - » Accumulated Invoice Line Items vs. Payment
  - » Accumulated Invoices vs. Bulk Payment

- Unmatched (Join) – Orphaned records or missing records
  - » Unauthorized Users: Requisitions, Purchaser

Using analytics to produce audit parameters in response to entity risks are difficult. Auditors must find the appropriate balance between applying auditor judgment and relying on the results of these analytics. Potentially, the AICPA could develop virtual audit guides to assist in determining analytics to use, and approaches to the setting up parameters from which to use to determine exceptions.

STEP 5. INVESTIGATE EXCEPTIONS

This process is supported through complete documentation and resolution of each exception. The conclusions reached are the audit evidence needed to support the auditor's conclusion.

Approaches to the investigation of exceptions will evolve and may need clarification by the Auditing Standards Board. For example, if an auditor concludes that a certain percent of the transactions analyzed are an exception, will the auditor be required to examine 100 percent of those transactions, or can the auditor sample the population containing the exception and then project the results of the sample to the population?

STEP 6. ACTION, CONCLUSION AND VALUE ADD

This section is where the auditor draws their conclusion on the financial statements under audit and offers value added advice based on the knowledge gained for this approach.

OTHER CONSIDERATIONS

It is a significant leap to go from our current traditional audit approach to one that integrates big data and analytics in a seamless manner. There are a number of barriers to the successful integration of big data and analytics into the audit, though they are not insurmountable. This journey allows time for the AICPA to educate and assist firms in migrating from the current state to the next generation state.

The audit of the next generation will also require deeper training in areas outside the typical auditor's historic skill sets. While in some cases the audit already uses the skills of other disciplines (risk management, forensic and IT), the auditor of tomorrow must increase their understanding of these non-traditional disciplines and work more closely than ever before with data and analytics specialists.


ACCOUNTability Plus, LLC
DRIVING ACCOUNTING FIRM EXCELLENCE